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ENERGY FOR GINA ERICKSON

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TAGS: ENRG EPET ECON EINV PREL EFIN PGOV LY
SUBJECT: AL-QADHAFI'S FEINT: LIBYAN OIL NATIONALIZATION UNLIKELY

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REASON: 1.4 (b), (d)

¶1. (C) Summary. During a recent video conference with Georgetown University students, Muammar al-Qadhafi suggested that Libya and other oil exporting states could nationalize their oil production in view of sharply plummeting petroleum prices. Several days later, however, a sensior MFA official assured the visiting Spanish King's delegation that Libya does not intend to do so. In typical fashion, al-Qadhafi's call for nationalization was ill-defined and left considerable room for interpretation. Industry experts in Washington and Libya have not entirely dismissed the possibility that the GOL could nationalize its oil and gas sector (Libya did so in 1972); however, they do not currently judge it to be a serious threat and are waiting to see whether legislation proposing such an initiative is introduced in advance of the upcoming session of the General People's Congress. Informed contacts view the call for nationalization as a tactical move to: 1) leverage the expected re-negotiation of existing contracts with international oil companies (IOCs'); 2) prompt IOC's operating in Libya to contribute to the U.S.-Libyan claims compensation fund; 3) establish a context for Libya's potential unilateral cuts in production of oil below levels dictated by OPEC, and; 4) prepare the Libyan people for the fact that this year's GOL budget, which will be introduced at the General People's Congress session, will be adversely impacted by falling oil revenues and the global financial crisis. The GOL is in the midst of a painful recalculation of its 2009 national budget to reflect lower oil revenues. Suggesting nationalization - an idea al-Qadhafi attributed to members of the local-level Basic People's Congresses and can therefore disavow easily - clearly signals the extent to which sagging oil prices and the global financial crisis have hurt oil-dependent economies like Libya's, helping pre-empt criticism from abroad if/when Libya makes further unilateral production cuts below OPEC-dictated levels and from regime elements when big ticket development projects are scaled back or cut. Al-Qadhafi's real intent may have been to shift the goalposts of debate so that the steps he ultimately takes seem comparatively palatable. End summary.

AL-QADHAFI THROWS A CURVEBALL

¶2. (C) During a wide-ranging video conference with Georgetown University students on January 21, Muammar al-Qadhafi raised the topic of oil, saying " ... oil-exporting countries might opt for nationalizations due to the sharp fall in oil prices". His speech was foreshadowed by articles in state-run newspapers, later picked up by Reuters, saying that members of the Basic People's Congresses (the lower part of the pyramid scheme of legislative committees and congresses that form the GOL) had called for nationalization. Noting sharply plummeting oil prices, al-Qadhafi suggested that oil production should be temporarily curtailed or stopped altogether to spur higher

prices and suggested that a price point of USD 100/barrel was needed to underwrite Libya's ambitious infrastructure development projects. Libya's former senior representative to OPEC, Abdullah al-Badri, told the press on January 23 that nationalization could be "in the offing" and suggested that events in Gaza may have partly prompted the proposal. At a National U.S.-Arab Chamber of Commerce lunch in Houston on January 27, Libya's Ambassador to Washington, Ali Aujali, said the GOL had not ruled out nationalization and characterized a USD 100/barrel price point as "fair". The NOC directed oil companies producing in Libya to cut production by 270,000 barrels per day in compliance to an output-cutting decision adopted by OPEC.

¶3. (C) During the recent visit to Tripoli of Spanish King Juan Carlos I, al-Qadhafi was quoted as saying that " ... if Libya ends up taking this decision, it will be because we don't have any choice". Despite the public threats, MFA Secretary for Arab Affairs (U/S-equivalent) Muhammad Siala told the Spanish delegation that oil production would not be nationalized. In remarks to Spanish daily "El Pais", Spanish energy giant Repsol's President, Antoni Brufau, speculated that al-Qadhafi had been "thinking out loud" (further details septel). A well-connected contact in Tripoli who is a close friend of Libyan National Oil Chairman Shukhri Ghanem told the Ambassador on January 29 that Ghanem had not taken the press reports or al-Qadhafi's remarks seriously and did not consider nationalization of Libya's oil production as a serious or plausible possibility. Ghanem was "extremely frustrated" that he had not been consulted or informed before al-Qadhafi gave his remarks, and told our contact he was "fed up" and waiting for an opportunity to leave his position at the NOC.

GOL WANTS TO RENEGOTIATE EXISTING PRODUCTION CONTRACTS, INCREASE

ITS SHARE

¶4. (C) Part of the issue may be definitional. Although al-Qadhafi has used the phrase "nationalization", he may in fact be signaling more aggressive efforts by the GOl and NOC to secure greater shares of oil produced under existing contracts. During 2008, the NOC renegotiated four existing production contracts with Italy's ENI, Canada's Petro-Canada, a consortium of U.S. Occidental/ Austrian OMV, and a European consortium of Spanish Repsol/French TOTAL/Austrian OMV/ Norwegian Hydro (reftels A, B, C, D). According to a recently-released NOC report, the renegotiated contracts increased the GOL's earnings by USD 5.4 billion last year; the four companies involved also paid USD 3 billion in front-end bonuses, increasing the GOL's take. The renegotiated terms brought those contracts in line with Libya's preferred exploration and production sharing agreement (EPSA) rubric, under which IOC's already producing in Libya have extended their contracts, paid sizeable bonuses and dramatically reduced their production shares to the neighborhood of 10-15 percent. The NOC has repeatedly said it wants to renegotiate its old (i.e., non-EPSA) contracts along EPSA-IV terms, which would allow it to have more than an 80 percentage share.

¶5. (C) The Oasis Group (ConocoPhillips, Marathon, Hess and Occidental), Repsol, Wintershall and Total remain as the foreign producing companies that have not signed the new agreements to align their share percentages with the most recent EPSA-IV configuration. The Oasis Group, whose constituent members' assets and production were nationalized in 1972, agreed in 2005 to pay Libya USD 1.8 billions to return to their previous acreage, which had been held in trust under a "stand fast agreement" for 19 years during the period U.S. sanctions were in effect against Libya. Oasis' contract is for 25 years; the NOC holds a 59.2 percent share, ConocoPhillips and Marathon each have 16.33 percent each, and Hess has an 8.16 percent share. The GOL would like to renegotiate Oasis' contract to increase its share, and has informally signaled that it intends to do so.

¶6. (C) At the same time, industry journals report that the re-negotiated contracts with IOC's will entail investment in exploration and production of some USD 22 billion over the next 5-10 years. Libya would bear up to 50 percent of that financial burden, at a time when it may already have to scale back its infrastructure development projects in light of falling revenues (ref E). The GM of Canada's Verenex (one of the few companies

to find new oil under new EPSA's) said nationalization "did not make sense" since the NOC would have to bear bear 100 percent of development and production costs. By way of example, the NOC only bears 50 percent of Verenex's development costs, but gets 87 percent of production revenues.

CLAIMS COMPENSATION FUND CONTRIBUTIONS

¶7. (C) In addition to providing leverage for potential renegotiation of existing contracts, the threat to nationalize may in part be an attempt to prompt IOC's operating in Libya to contribute to the U.S.-Libya claims compensation fund that was implemented in October 2008. Marathon's General Manager (GM) told the Ambassador that the NOC Chairman Shukhri had begun soliciting IOC's again about two weeks ago for contributions to the fund established to compensate U.S. victims of acts of terrorism authored by Libya. The NOC had previously targeted only companies that were producing oil; however, in its most recent approach it also touched IOC's that are in the exploration phase and have not yet begun producing oil. Representatives of Occidental said the company was concerned about press reports, but not overly so. Oxy has received private assurances from Ghanem that nationalization is not the in the offing, and views al-Qadhafi's remarks as posturing to pressure companies to contribute to the fund. GM's of major IOC's here believe that the first-tier producers, who have so far abided by an informal agreement not to accede to demands for contributions, will continue to hold the line; however, there is concern that second-tier producers and perhaps oilfield supply and services companies may buckle under pressure from the NOC and choose to contribute. A second meeting between IOC GM's and Ghanem that was to have occurred on January 28 has been postponed until February 1 or 2, according to Occidental's GM.

PORTENT OF FURTHER UNILATERAL PRODUCTION CUTS BY LIBYA?

¶8. (C) Remarks by al-Qadhafi and other senior GOL officials may also have been intended to establish a context for potential unilateral cuts in Libyan production of oil below levels dictated by OPEC. Three OPEC production cuts since September,

most recently a 2.2 million barrel per day cut that went into effect January 1, have failed to slow a slide that has left crude oil prices about 70 percent below the mid-July 2008 price of USD 150 per barrel. Libya directed IOC's in Libya to cut their production by 270,000 barrels per day (Libya's total production is 1.7-1.8 million barrels/day), more than it needed to account for its share of the overall OPEC cut. In his Georgetown remarks, al-Qadhafi flatly said that Libya would not adhere to OPEC's quotas " ... because our livelihood depends on oil". He also suggested that further unilateral production cuts or perhaps even a temporary production freeze could be adopted, although either of those options would result in further declines in revenue at a time when the GOL can ill afford it.

CREATING A DIVERSION IN ADVANCE OF THE UPCOMING GENERAL PEOPLE'S CONGRESS?

¶9. (C) Finally, al-Qadhafi's remarks may be part of an effort to prepare regime figures and, to a lesser extent, the Libyan people for the fact that this year's GOL budget, to be introduced at an upcoming session of the General People's Congress (GPC), will be adversely impacted by falling oil revenues and the global financial crisis. As reported ref E, the session planned for January was postponed, in part because the GOL has had to re-calculate the national budget to reflect dramatically reduced oil revenues. A senior MFA official told us that al-Qadhafi, unhappy that widely-publicized infrastructure and development projects designed to demonstrate the Jamahiriya system's benefits, tried to secure funds from Libya's newly-constituted Sovereign Wealth Fund (SWF) to cover budget shortfalls and avoid delaying the projects. The President of the Libyan Investment Authority, which administers the SWF, told the Ambassador that a recently-adopted law prohibits such raids on the fund, and al-Qadhafi appears to have been deterred from doing so (at least for now).

¶10. (C) Comment: Famous for saying the unexpected (a favorite local saying is "from Libya comes the new"), al-Qadhafi did not disappoint with his threat to nationalize Libya's oil production. As with similar dramatic, headline-grabbing

statements on various other subjects in the past, though, much of what he says and does represents tactical maneuvering rather than a sincere expression of intent. While it is never wise to rule out the possibility of seemingly irrational decisions by the GOL, we are not inclined to believe that nationalization is being seriously considered. Floating the idea helps leverage the GOL's position with respect to renegotiating existing oil production contracts and (potentially) garnering contributions to the claims compensation fund. More important in the immediate sense, though, is that it clearly signals the extent to which sagging oil prices and the global financial crisis have hurt oil-dependent economies like Libya's, helping pre-empt criticism from abroad if/when Libya makes further unilateral production cuts below OPEC-dictated levels and from regime elements when big ticket development projects are scaled back or cut at the upcoming session of the GPC. In that regard, al-Qadhafi's real intent may have been to shift the goalposts of debate so that the steps he ultimately takes seem palatable by comparison with the specter of what could have been.
Well-connected businessman Husni Bey (strictly protect) told the Ambassador that he doubted that the GOL would "make the same mistake twice" by nationalizing oil production again, and highlighted the fact that al-Qadhafi attributed authorship of the idea to the BPC's, which would make it easier for him to later disown it. Tellingly, MFA A/S-equivalent for the Americas Ahmed Fituri told the Ambassador on January 28 that he did not expect nationalization to occur, and had attended a meeting earlier that day in which participants discussed opening a consulate in Houston, in part to better facilitate travel to/from Libya by U.S. oil representatives. End comment.
CRETZ